

The Tax Commissioner's Discretions and Indiscretions

Ray Conwell, Justin Dabner and Paul Glover

Australia's taxation law is rendered uncertain by the increasing use of statutory and non-statutory discretions. Ray Conwell, Justin Dabner and Paul Glover, of Deloitte Ross Tobmatsu, argue that self-assessment of tax liabilities will fail unless the tax system is simplified by less reliance on discretions and by the establishment of an effective appeal and review procedure.

The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person.

These words were written by Adam Smith in 1776 in *The Wealth of Nations*. Australia's present tax system fails every one of Adam Smith's tests. While discretions have been present in our taxation law from the very beginning, the widespread, increasing and almost uncontrolled use of this legislative device over recent years has made our taxation system complex, unclear, anything but certain, and almost arbitrary. Not only is it difficult to ascertain the amount of tax for which individuals are liable, but even the manner of payment — tax instalments, prescribed payments, provisional tax, withholding tax, etc. — is often unclear; and the time of payment, particularly under the new company self-assessment system and the proposed full self-assessment system, may be quite difficult to determine.

In a consultative document entitled *A Full Self Assessment System of Taxation*, which formed part of the federal Treasurer's tax simplification statement of 13 December 1990, the government has finally committed itself to a review of the Commissioner's discretions contained within the Income Tax Assessment Act (ITAA). The aim is to eliminate as far as possible those discretions authorising the Commissioner to ascertain elements of taxpayers' taxable income, and to replace them with explicit rules. Those discretions pertaining to the Commissioner's administrative duties or the protection of the revenue (i.e. anti-avoidance discretions) are to be largely retained. But the proposed reduction in the number of the Commissioner's discretions is a necessary and overdue step towards the simplification of the Australian taxation system.

Statutory and Non-Statutory Discretions

The 1915 version of our ITAA contained only 37 discretionary powers. By 1969 this number had exceeded 300 (Wheatcroft, 1969); five years later some

467 discretionary powers in the ITAA were identified, or over 700 if account was taken of ancillary and subordinate taxing legislation. During the last 15 years this figure has probably doubled if not trebled.

In addition to these statutory discretions, recent developments in tax administration have witnessed the growth in the exercise of *de facto* or non-statutory discretions, which are said to arise from the need to administer the law fairly. Instances of non-statutory discretions include: the 1988 tax amnesty; the allowance in most circumstances of a tax rebate under section 46 in respect of dividends where the taxpayer is the beneficial owner of the relevant shares but the shares are registered in the name of a corporate nominee; and the recent tendency of the Commissioner to 'interpret' the law in a manner that is clearly at variance with the statute on the ground that he is giving effect to 'the policy'.

Statutory discretions may not be arbitrary in a strict legal sense. But the same cannot be said of non-statutory discretions, which by their nature are exercised in an ad hoc manner at the whim of the Commissioner and his officers. The idea that they are necessary for the fair administration of the law is extremely dubious. The recent decision in *David Jones Finance and Investment Pty Ltd v. FCT* 90 ATC 4730 demonstrates that taxpayers may have no or little protection where the Commissioner changes his mind in relation to a previously-exercised non-statutory discretion or practice. This critical decision is analysed below.

It is in this climate of uncertainty that the government has decided to implement self-assessment. Taxpayers are to be required not only to determine what the law is, but to speculate on how the Commissioner is likely to exercise his discretions, if at all, and then account for their tax liability accordingly.

Discretions and the Right of Review and Appeal

The introduction of self-assessment has rekindled the debate over the desirability of discretionary powers. The trend towards incorporating extensive discretionary powers has traditionally been justified as a response

to the variety and sophistication of transactions and other contingencies that are beyond the imagination of mortal draftsmen. Experiences during the 1970s highlighted the need for flexibility in the administration of the ITAA, and the draftsmen responded accordingly. However, hiding behind the cloak of the discretion can often be an easy way out for a draftsman or policymaker who is unable to state clearly the principles to be given statutory form.

The effect, if not a purpose, of adding discretions to statute law is to circumscribe taxpayers' rights of review and appeal. Professor Wheatcroft (1969) conceded that the majority of discretions then existing were reasonable. However, he was concerned that discretions should be reviewable and was impressed by the significant powers of review given to Australian taxpayers. Unfortunately, Australian taxpayers' rights to review have since been significantly curtailed, specifically as a result of the transfer of the review process from the Taxation Board of Review ('the Board') to the Administrative Appeals Tribunal (AAT). Where a former Board decision was taken on appeal to a court, the right of appeal was expressed to occur where a question of law was **involved** in the Board decision. This meant that, once a question of law was identified in the Board's decision, the **whole** decision was open to review by the court. This was often referred to as a hearing *de novo*. The practical effect was that neither the Commissioner nor the taxpayer was bound by the evidence before the Board, but could elect to have the evidence reheard or additional evidence adduced.

In contrast, appeals to the AAT are restricted to appeals **on** questions of law. That is to say, only questions of law may at present be referred from the AAT to a court exercising judicial power; errors of fact may not be the subject of review. This curtailment of taxpayers' rights under the AAT Act has been the subject of judicial comment; Gummow J in *TNT Skypak International (Aust) Pty Ltd v. FCT* 88 ATC 4270 observed that the restriction on the right of appeal might be unconstitutional.

'Administrative Common Sense'

The justification for the exercise of non-statutory discretions (or, if you like, indiscretions) is embodied in the concept of 'administrative common sense' referred to by Lord Wilberforce in *Vestey v. Inland Revenue Commissioners* [1980] AC 1149. In relation to the activity of the Commissioners, his Lordship commented:

Of course they may, indeed should, act with administrative commonsense. To expend a large amount of taxpayers' money in collecting, or attempting to collect, small sums, would be an exercise in futility: and no-one is going to complain if they bring humanity to bear in hard cases.

However, this is clearly a very limited principle because his Lordship went on to say:

When Parliament imposes a tax, it is the duty of the Commissioners to assess and levy it upon and from those who are liable by law . . . but this falls short of saying that so long as they do not exceed a maximum they can decide that beneficiary A is to bear so much tax and no more or that beneficiary B is to bear no tax. This would be taxation by self-asserted administrative discretion and not by law . . . One should be taxed by law, and not be untaxed by concession.

Similarly, Lord Edmond-Davies stated:

No judicial countenance can be, or ought to be, given in matters of taxation to any system of extra-legal concessions. Amongst other reasons, it exposes revenue officials to temptation, which is wrong, even in the case of a service like the Inland Revenue, characterised by a wonderfully high sense of honour. . . The issue remains, however, as to what are the limits of the discretion envisaged by the expression 'administrative commonsense'.

Some guidance is offered by the House of Lords decision in *Inland Revenue Commissioners v. The National Federation of Self-employed and Small Businesses Limited* [1982] AC 617. Under an arrangement to combat the use of false names in the newspaper industry, the Commissioners agreed that, if future tax were deducted at source, no investigation into lost tax would be carried out. Although the majority of their Lordships concluded that the plaintiff had no standing to bring the proceedings, they held that the Commissioners were acting genuinely in the care and management of the tax laws entrusted to them by the statute.

Lord Diplock referred to the 'wide managerial discretion as to the best means of obtaining for the National Exchequer from the taxes committed to their charge, the highest net return that is practicable having regard to the staff available to them and to the cost of collection'. Similarly, Lord Roskill referred to the arrangement as 'sensible' and 'in the best interests of everyone involved', and 'likely to lead to a greater collection of revenue than if the agreement had not been reached or amnesty granted'.

This decision was followed in *Preston v. Inland Revenue Commissioners* [1985] 2 All ER 327. This case involved an alleged agreement between the taxpayer and the Commissioners whereby the taxpayer offered to withdraw his claims for relief if the Commissioners settled his tax affairs for the years in question and raised no further inquiries into these affairs. Some years later the Commissioners learned that certain shares had been sold in a tax-avoidance scheme prior to the alleged agreement. The taxpayer sought judicial review of what was claimed to be breach of the

agreement. In delivering the principal judgment Lord Templeton remarked that no breach of contract was involved because the Commissioners could not bind themselves not to perform in 1982 the statutory duty they had of counteracting a tax advantage. He referred to the duty of fairness owed by the Commissioners to the general body of taxpayers and continued:

The Commissioners may decide to abstain from exercising their powers and performing their duties on grounds of unfairness, but the Commissioners themselves must bear in mind that their primary duty is to collect, not to forgive, taxes.

Until very recently, the only Australian case that touched upon the issue was the High Court decision in *Queensland Trustees Limited v. Fowles* (1910) 12 CLR 111. The Chief Commissioner of Stamps in Queensland had entered into an agreement in relation to the payment of certain stamp duty. It was held that the agreement was within the Commissioner's express powers and as a matter of fact to have been made with the authority of the government. Nevertheless, Griffith CJ went on to recognise that:

In the powers of administration there must be included a power in the Government to make an agreement necessary for fair and reasonable administration.

However, it could be inferred from the decision that some members of the Court may have held, in the absence either of an express power of the Commissioner or of the authority of the Executive, that the Commissioner did not have the power to do that which the Act did not empower. Thus, it could be argued that if anyone had the power to release taxes it would be the Treasurer, as the appropriate minister responsible, rather than the Commissioner. This would be consistent with the legislative policy contained in the Commonwealth Audit Act granting to the Minister for Finance the power of 'writing off' irrecoverable taxes.

The position established by these cases would appear to be that, although the Commissioner can, under his general administrative power, compromise litigation if he is of the bona fide view that to do so is in the general interest of the revenue, he has no general power (relief powers aside) to release a taxpayer from tax. Similarly, the Commissioner cannot bind himself or his successors to exercise his statutory powers or discharge his statutory duties in a particular way.

The David Jones Finance Decision

This position has been largely confirmed by the recent Federal Court and Full Federal Court decisions in *David Jones Finance and Investment Pty Ltd & Anor v. FC of T* 90 ATC 4730. The Commissioner assessed the taxpayers in respect of certain years of income on the basis that they were not entitled to a dividend rebate

under section 46(2) of the ITAA, since they were not the registered legal owners of the relevant shares.

The Commissioner's actions were justified in law by the High Court decision in *Patcorp Investments Ltd v. FC of T* 76 ATC 4225 but were contrary, the taxpayers argued, to his previous well established practice (of some 30 years) of allowing the rebate where corporate taxpayers beneficially owned shares that were registered in the name of corporate nominees. This concessionary Tax Office practice had apparently continued despite the contrary decision in the *Patcorp* case.

Statutory discretions may not be arbitrary in a strict legal sense. But the same cannot be said of non-statutory discretions, which by their nature are exercised in an ad hoc manner at the whim of the Commissioner and his officers. The idea that they are necessary for the fair administration of the law is extremely dubious.

The issue considered in the *David Jones Finance* case did not concern an appeal from the disallowed objections of the taxpayers but rather the seeking of orders by the taxpayers restraining the Commissioner from taking action in order to recover the tax assessed and declaring that the notices of assessment issued were not assessments of income tax. The taxpayers argued that the intervention of the Court was justified due to the Commissioner's departure from his long-standing practice without warning and with retrospective effect. This departure allegedly constituted an abuse of power by the Commissioner since it defeated the taxpayers' 'legitimate expectations' and was contrary to the obligation of administrative 'fairness' placed upon the Commissioner.

The taxpayers' applications were dismissed at first instance in the Federal Court before O'Loughlin J. The basis of the decision was that where a taxpayer seeks to

challenge an assessment, he is limited to the objection/appeal procedures contained in Part V of the ITAA; accordingly, the Court did not have the jurisdiction to intervene and grant the orders sought by the taxpayers. O'Loughlin J did acknowledge, however, that the Commissioner is amenable to judicial review in respect of matters of general administration and in matters concerning the exercise of discretionary powers. It is apparent from certain comments made by O'Loughlin J that should the taxpayers have objected against the Commissioner's valid assessments and subsequently appealed, the appeal would be determined not by the

The wide use of discretions in our tax legislation renders the level of taxation in Australia in the last decade of the 20th century one of the least certain matters facing the citizens of this country. What is certain is that virtually everyone will have trouble determining how much tax he or she ought to pay.

acts or omissions of the Commissioner but the terms of section 46(2) itself as authoritatively interpreted by the High Court in the *Patcorp* case.

The taxpayer's appeal from O'Loughlin J's decision to the Full Federal Court was successful. Morling and French JJ (Pincus J dissenting) set aside the decision dismissing the taxpayers' application and dismissed a motion of the Commissioner that the Court had no jurisdiction to make the orders sought by the taxpayers. Morling and French JJ held that section 177 of Part V of the ITAA could not displace the jurisdiction conferred on the Court by section 39B of the Judiciary Act (Cth); the proper exercise of that jurisdiction would result in the 'due making' of the assessment and the amount of all particulars thereof being open to inquiry. Furthermore, it was not necessary for the Court to determine

finally whether the nature of the abuse and excess of power alleged by the taxpayers would, if established, represent a bona fide attempt by the Commissioner to exercise his power. It was sufficient to say that the point was arguable.

In his dissenting judgment, Pincus J held that the application of section 177(1) was not intended to be excluded or limited by section 39B of the Judiciary Act. Any proceedings brought under section 39B alleging an abuse of power in the issue of an assessment would, in the view of Pincus J, be effectively answered by the Commissioner tendering a notice of assessment.

The Full Federal Court decision in the *David Jones Finance* case is clearly a landmark decision, giving taxpayers the prospect of challenging tax assessments under administrative law rather than under the ITAA. It seems to provide taxpayers with the possibility of some protection in the case of the exercise by the Commissioner of non-statutory discretions, at least where the Commissioner alters his previous practice retrospectively or without warning. Whether or not the High Court will confirm the decision is a question the answer to which will be eagerly awaited by taxpayers and the Commissioner alike. Notably, the Commissioner's application for special leave to appeal was dismissed by the High Court on 5 August on the basis that the dispute between the parties had been settled. However, the High Court did indicate that the matter was worthy of its consideration should the appropriate case arise. Should the High Court subsequently find in favour of the taxpayer in such a case, a legislative amendment to exclude the challenge of assessments under administrative law must be a strong possibility.

At the time of writing, the full implications of the Full Federal Court decision are uncertain. But it seems clear that the taxpayers will not proceed with their administrative law challenge against the Commissioner's refusal of section 46 rebates since, only weeks before the decision, they reached a settlement with the Tax Office of outstanding assessments up to 30 June 1990. On the other hand the Commissioner is almost certain to seek leave to appeal to the High Court in order to prevent what was described by Pincus J as a 'substantial weakening' of a 'critical part of the tax collection system'.

Implications for Full Self-Assessment

The proposed move to full self-assessment as disclosed in the consultative document issued on 13 December 1990 promises to cause even more problems for taxpayers. Although the proposed system of private and general rulings will be binding on the Commissioner, this will not elevate rulings to the status of law. Rulings will still be subject to review by the AAT, and the courts and, therefore, taxpayers will continue to follow them at their peril.

Paragraphs 4.11 and 4.12 of the consultative document state:

Where a Taxation Ruling applies to a taxpayer's circumstances, the Commissioner would be bound by the opinion expressed in the Ruling so far as it applies to the taxpayer's circumstances and provided that there has been no change in the law. It could be necessary to depart from a ruling, for example where there has been legislative change or a judicial or quasi-judicial decision altering the basis of the ruling provided. **Subject to any legislative constraint, a departure from the Commissioner's ruling would be on a prospective basis only.** Where a Taxation Ruling is issued which departs from a previously issued Taxation Ruling or private ruling, **the new Taxation Ruling would apply prospectively.**

Although the Commissioner would be bound by private rulings they would be subject to review by the Administrative Appeals Tribunal and the Courts. **The purpose of binding rulings would be to provide certainty and to protect taxpayers who had entered into transactions and calculated their tax liability on the basis of the Commissioner's decision as it applies to their circumstances.** (emphasis added)

Paragraph 6.25 states:

Where a Taxation Ruling or a **relevant judicial decision** alters the application of the law, the Ruling or decision would be **generally applied prospectively.** They would not apply to returns previously lodged with the Tax Office. It follows that the taxpayer would not be required to self amend to give effect to a Taxation ruling or judicial decision **on a retrospective basis.** (emphasis added)

The Treasurer promises a lot under the new self-assessment system. Not only will the taxpayer be able to find protection upon following a relevant ruling, but any change in law following a judicial decision will be 'generally' applied prospectively. As illustrated by the case law discussed above, however, the Commissioner does not have the power, as the ITAA is presently drafted, to administer the law other than according to its strict letter. The role of the Commissioner as administrator must radically change under the new system if the aims contained in the consultative document are to be achieved. He must, at least to some extent, become a lawmaker or a court.

Conclusions

There can be little doubt that the tax system in Australia today is a far cry from the ideal tax world of Adam Smith.

The wide use of discretions in our tax legislation renders the level of taxation in Australia in the last decade of the 20th century one of the least certain matters facing the citizens of this country. What is

certain is that virtually everyone will have trouble determining how much tax he or she ought to pay.

Given that our tax laws are almost incomprehensible, one would expect government to provide assistance to taxpayers to interpret, understand and comply with their taxation obligations. In fact, the opposite is the case. Increasingly, the Australian Taxation Office, under pressure from government to cut its resources and reduce the cost of collecting revenue, has no alternative but to push more and more of the responsibility for coming up with the right answer on to taxpayers themselves. And faced with the almost impossible task of retaining its most competent staff, the Taxation Office is simply unable to provide a high-quality advisory service for taxpayers. Although from the Commissioner's perspective, the shift from an assessment process to audit and self-assessment is no doubt justified in purely cost-benefit terms, the chances of any taxpayer, however competently advised, interpreting the tax laws in the way the Taxation Office would are probably much the same as his chances of winning the lottery.

The introduction of the non-statutory discretion represents a major shift in the use of discretionary powers that has exponentially increased the uncertainty faced by taxpayers. Some administrative discretion is admittedly a practical necessity; but an effective review and appeal structure needs to be established. While the introduction of the Freedom of Information legislation and the Administrative Decisions (Judicial Review) Act have provided a welcome extension of taxpayers' rights in contesting the exercise of statutory discretions under the tax laws, the transfer of the review process to the AAT was a retrograde step. That is not to say that many aspects of the 1986 changes to the tax review process are not to be welcomed. The right to seek an extension of time to lodge objections and appeals and to add new grounds of objection during the review are clearly of benefit to taxpayers. But the quality of the review process has suffered and taxpayers' appeal rights have been seriously curtailed. This is an area of the tax law that requires urgent intervention by either parliament or the High Court.

Whereas economists dream of a level playing field, tax practitioners dream of certainty, which, to further the analogy, requires that the goal posts remain in the same position throughout the match and that the official umpire retains absolute control.

Reference

Wheatcroft, G. (1969), 'Taxation by Administrative Discretion', pp.1-26 in First National Tax Convention, *Taxation Now and in the Future*, Canberra.

Ray Conwell is the partner-in-charge of the Victorian tax division of Deloitte Ross Tohmatsu, Justin Dabner is the National Tax Technical Director, and Paul Glover is a tax senior.